HUMBOLDT WEDAG GMBH & ANOR v. PERAK-HANJOONG SIMEN SDN BHD

HIGH COURT MALAYA, KUALA LUMPUR
ABU BAKAR JAIS JC
[SUIT NO: 24NCC-293-08-2014]
2 MARCH 2015

CONTRACT: *Guarantee – Bank guarantee – Call on bank guarantee after taking over works by defendant – Whether bank guarantee already expired – Whether works had been fully completed in accordance with specifications – Whether plaintiffs succeeded in raising ground of unconscionability – Whether defendant had taken bank guarantees to its advantage unfairly – Whether defendant provided concrete reason for calling on bank guarantee*

The plaintiffs, pursuant to an agreement in writing ('the contract') dated 23 February 2012, agreed to perform certain works and it was, *inter alia*, an express term of the contract that the plaintiffs provided the defendant certain bank guarantees. The plaintiffs duly provided the bank guarantees. Subsequent to performance tests that were carried out, the defendant requested that the plaintiffs make good certain defects after the take over in accordance with cl. 30.5 of the contract. The defendant commenced commercial operations on the facility on or about 30 July 2014. However, more than 14 days after having taken over the works and acknowledging the same, the defendant demanded payment under the bank guarantees by letters dated 15 August 2014. Hence, this application by the plaintiffs for an injunction that the defendant be restrained from calling and receiving monies or payment under the bank guarantees pending a final award in an impending arbitration. The plaintiffs submitted that as the works had been completed and acknowledged by the defendant, it was unconscionable for the bank guarantees to be called.

Held (allowing plaintiffs' application for injunction):

(1) Since the facility was taken over on 30 July 2014, the bank guarantees would have expired on 13 August 2014, *ie*, 14 days after the taking over pursuant to cl. 9.1 of the contract and express terms of the bank guarantees. Hence, the bank guarantees had expired. In the circumstances, the demands dated 15 August 2014 were unconscionable as the facility was deemed to have been accepted prior to 30 July 2014, when the performance tests showed that minimum performance requirements were met. (paras 25, 28 & 29)

(2) The works undertaken by the plaintiffs had been completed and even if it was not fully completed to the specifications, these were matters to be arbitrated as agreed by the parties. The calling of the bank guarantees under the circumstances could not be justified and was most unfair. It also amounted to an unconscionable act by the defendant. (para 32)

(3) The reason to provide for bank guarantees in the construction industry is to provide security to the beneficiary or owner of a project of construction against contractors who had failed to complete the works in time and according to the specifications. However, the instrument in the form of the guarantees cannot be used at the whim and fancy of the beneficiary or owner. There must be concrete reason why a bank guarantee is being called. The defendant in the instant case had taken the bank guarantees to its advantage unfairly simply because there were such guarantees. It had acted to capitalise on the availability of the guarantees without cogent reasons. (paras 33 & 34)

(4) The deductions sought by the defendant were also premature as the plaintiffs had the right to make good of the defects within a reasonable time after the take over pursuant to cl. 30.5 of the contract. The deduction for diminution in value was also premature. Even if they were not premature, the deduction should have been made on the defects liability bond, which was to be issued for the period after the take over and not on the bank guarantees that were valid before the take over. (paras 35, 36 & 37)

(5) There were genuine disputes between the plaintiffs and the defendant that should be decided by arbitration on whether the defendant had in fact failed to pay the plaintiffs some certified amount. The disputes also pertained to claim for interim payment and losses and expenses that the plaintiff alleged the defendant had failed, neglected and omitted to pay the plaintiffs. (para 39)

(6) There was a real possibility to be decided in the arbitration that there were large unpaid certified sums due by the defendant to the plaintiffs as asserted by the latter. It was for the arbitration to decide whether the plaintiff was able to prove it. However, it would be unconscionable for the defendant to proceed in demanding the bank guarantees at this stage. (para 40)

Case(s) referred to:

Bakti Insani Sdn Bhd v. Pembinaan BLT Sdn Bhd & Anor (Unreported Case) ***(refd)***

Focal Asia Sdn Bhd & Anor v. Raja Noraini binti Raja Datuk Nong Chik & Anor [2009] 1 LNS 913 HC ***(refd)***

Kejuruteraan Bintai Kindenko Sdn Bhd v. Nam Fatt Construction Sdn Bhd & Anor [2011] 7 CLJ 442 ***(refd)***

Nafas Abadi Holdings Sdn Bhd v. Putrajaya Holdings Sdn Bhd & Anor [2004] 1 LNS 127 HC ***(refd)***

Petrodar Operating Co Ltd v. Nam Fatt Corporation Bhd & Anor [2012] 8 CLJ 311 CA ***(refd)***

Sumatec Engineering and Construction Sdn Bhd v. Malaysian Refining Company Sdn Bhd [2012] 3 CLJ 401 FC ***(refd)***

For the plaintiffs - T Baskaran (Suhanthi Sivanesan with him); M/s Zul Rafique & Partners
For the defendant - Felix Dorairaj (Annette Rachel Edwin with him); M/s Dorairaj, Low & Teh

Reported by S Barathi

JUDGMENT

Abu Bakar Jais JC:

Introduction

[1] The plaintiffs' originating summons ('OS') before this court for determination is for an injunction that the defendant be restrained from calling and receiving monies or payment from a bank pursuant to the demands under three bank guarantees pending a final award in the impending arbitration.

Material Facts

[2] There is no reasons to depart from the salient facts provided in the written submission as narrated below.

[3] By an agreement in writing and dated 23 February 2012 ('the contract'), the plaintiffs agreed to perform certain works, more particularly described as the design, manufacture, supply, erection, construction, installation, testing and commissioning of two sets of roller press system for cement mill 3 and cement mill 4 at the defendant's plant located in Padang Rengas, Perak (the works), for the defendant.

[4] It is, *inter alia*, an express term of the contract that the plaintiffs will provide the defendant certain bank guarantees.

[5] The plaintiffs duly provided the bank guarantees, by agreements in writing and referenced 834BGG1200003, 834BGG1200003 and 834BGG1200003 (the bank guarantees), whereby Deutsche Bank (Malaysia) Bhd guaranteed the defendant in accordance with the terms set out therein.

[6] By letters dated 15 August 2014, the defendant demanded payment under the bank guarantees.

[7] The bank guarantees, *inter alia*, provide that:

> This bond shall expire fourteen (14) days after the date of issue of the Taking Over Certificate under the Contract but on 15.05.2013 ("Expiry Date") at the latest. We shall have no liability in respect of any claim under this bond received after the Expiry Date. We shall accept without further proof or condition the Beneficiary's confirmation whether or not such Taking Over Certificate has been issued.

[8] The bank guarantees were subsequently extended until 30 September 2014.

[9] Between 28 March 2014 and 31 March 2014, performance tests were carried out on Line 3 and 99.3% of the minimum performance requirements were met.

[10] Between 4 July 2014 and 6 July 2014, performance tests were carried out on Line 4 and the minimum performance requirements were met.

[11] About a month after the testing and commissioning of Line 4, by an email dated 7 August 2014, the defendant acknowledged that nine days had passed since production operation.

[12] By an email dated 8 August 2014, the defendant requested that the plaintiffs make good certain defects after take over in accordance with cl. 30.5 of the contract.

[13] By a letter dated 11 August 2014, the plaintiffs gave notice that the defendant was deemed to have accepted the facility under cl. 29.3 of the contract, as the defendant had acknowledged by their email dated 7 August 2014 that commercial operations had commenced. Furthermore, by their email dated 8 August 2014, the defendant requested that defects be made good after take over in accordance with cl. 30.5.

[14] By a letter dated 13 August 2014, the defendant acknowledged that a taking over certificate should be issued but had reservations.

[15] More than 14 days after having taken over the works, and acknowledged the same, by letters dated 15 August 2014, the defendant demanded payment under the bank guarantees.

By a taking over certificate dated 29 August 2014, the defendant formally took over the works.

[16] The defendant commenced commercial operations on the facility on or about 30 July 2014, as acknowledged by the defendant in the aforesaid email dated 7 August 2014.

[17] The defendant did not dispute the plaintiffs' letter dated 11 August 2014, which raised the fact that commercial operations had commenced but instead acknowledged in the defendant's aforesaid letter dated 13 August 2014 that the taking over certificate should be issued.

Plaintiffs And Defendant Contentions

[18] In summary the contentions of both parties are narrated as follows.

[19] The plaintiffs submit that as the works have been completed and acknowledge so by the defendant, it is unconscionable for the bank guarantees to be called. The same had expired since the defendant took over the facility.

[20] The defendant asserts that the plaintiffs committed fundamental breaches of the contract. The defendant also says the plaintiff is responsible for the delay in completing the works contracted. The defendant's further contested the plaintiffs' action on the ground that deduction should be made for the cost of making good defects and diminution in value from the bank guarantees.

Court's Findings

[21] First and foremost, in deciding whether the calling of the bank guarantees is to be upheld or otherwise, it is trite that the consideration material before the courts is to determine whether such demand is unconscionable or not.

[22] In this regard the leading and binding case pertaining to this point is the Federal Court's case of *Sumatec Engineering and Construction Sdn Bhd v. Malaysian Refining Company Sdn Bhd* [2012] 3 CLJ 401; [2012] 4 MLJ 1 where Abdull Hamid Embong FCJ it delivering judgment held;

> In my view the principle underlying the unconscionability doctrine is the prevention of oppression and unfair conduct; and because the determination of unconscionability is fact specific, courts must consider such a claim on a case by case basis and assess the totality of the circumstances.
>
> So, to answer the question posed to us, we say yes, unconscionability may now be raised as a distinct ground, to restrain a beneficiary under a bank guarantee or performance bond.

[23] The above case approved the judgment of the High Court, in *Focal Asia Sdn Bhd & Anor v. Raja Noraini binti Raja Datuk Nong Chik & Anor* [2009] 1 LNS 913; [2011] 2 AMR 515 which states:

> The Singapore Court of Appeal in *Bocoltra Construction Pte Ltd and Ors v. Attorney General (No. 2)* [1995] 2 SLR 733 accepted the legal position that the court will grant an interlocutory injunction restraining a beneficiary from calling on the bond on the ground of fraud or unconscionability. It appears that fraud or unconscionability is the sole consideration for the court in deciding whether an interlocutory injunction should be granted to restrain a beneficiary from calling on the bond. The court need not expend energy to consider where the balance of convenience lies or whether damages will be an adequate remedy.

[24] Taking note of the above decision, in the present case before this court there is no case of fraud as the parties here do not contend there is fraud in respect of the demand made on the bank guarantees. The sole issue therefore for this case is whether it was unconscionable on the part of the defendant to call on the bank guarantees.

[25] Further in the instance case too it is also relevant to note whether the bank guarantees were still subsisting when it were called or whether the same had expired. Since the facility was taken over on 30 July 2014, the bank

guarantees would have expired on 13 August 2014, ie, 14 days after the taking over pursuant to cl. 9.1 of the contract and express terms of the bank guarantees.

[26] In view of this fact, are the demands for the guarantees dated 15 August 2014 unconscionable as they were made after the same had expired?

[27] In this regard, in the unreported case of *Bakti Insani Sdn Bhd v. Pembinaan BLT Sdn Bhd & Anor* Justice Abdul Aziz Abdul Rahim said;

> On the above evidence, the Court is satisfied that the Plaintiff has succeeded in raising the ground on unconscionability with regard to the demand on the Performance Bond under prayer (b). This is because firstly the bond has expired on 11.11.2010 ie. one year after determination of the contracts works which was on 12.11.2009 – a fact not disputed by the 1st Defendant.

[28] This court based on the facts narrated is of the view indeed the bank guarantees had expired.

[29] Also the demands dated 15 August 2014 were unconscionable, as the facility was deemed to have been accepted prior to that on 30 July 2014 and Line 3 had met 99.3% of the minimum performance requirements by 31 March 2014 and Line 4 had met the minimum performance requirements by 6 July 2014.

[30] For this, the Court of Appeal's case of *Kejuruteraan Bintai Kindenko Sdn Bhd v. Nam Fatt Construction Sdn Bhd & Anor* [2011] 7 CLJ 442 is relevant where it states;

> In making the demands, on both the performance bonds, the beneficiary has not fulfilled the condition precedent as set out in cl. 24(c) of the underlying contract between them, that any demand on the performance bonds shall be premised on a breach of the contract to which the employer (GPSB) shall have issued to the beneficiary (with a duplicate copy to the appellant) a certificate in writing stating in his opinion the appellant has been in default. No such certificate was ever produced in court. The appellant has duly completed its obligations under the contract as evidence by the Certificate of Practical Completion (CPC) issued by JKR (at p. 209 of exh. A7 p. 551 - appeal (records).

[31] Also relevant is the case of *Nafas Abadi Holdings Sdn Bhd v. Putrajaya Holdings Sdn Bhd & Anor* [2004] 1 LNS 127; [2004] MLJU 148 where it held;

> Melihat kepada fakta kes, Defendan 1 sendiri telah mengakui bahawa Plaintif telah menyiapkan hampir 95% dari kerja-kerja di bawah *Building Contract* (Ekshibit A, Encl. 3). Malahan, perkara ini telah disokong oleh laporan perunding bebas, Barisan Jurutera Perunding Sdn Bhd, yang mengesahkan Plaintif telah pun menyiapkan 100% kerja-kerja fizikal di bawah kontrak berkenaan. Pada bila-bila masa fakta ini tidak disangkal oleh Defendan 1. Malahan, fakta juga menunjukkan bahawa Perbadanan

Putrajaya, yang merupakan pihak ketiga, telah menghantar surat kepada Plaintif dan Defendan 1 memaklumkan bahawa projek itu telah dibuka kepada awam dan fakta ini pun tidak disangkal oleh Defendan 1. Memandangkan keadaan fakta kes ini sendiri, maka mahkamah berpendapat tuntutan ini adalah telah dibuat secara tidak ikhlas (*unconscionable*). Malahan dengan menuntut kesemua jumlah wang di bawah Bank Guarantee tersebut, Plaintif telah melakukan *fraud* kerana tuntutan tersebut telah dilakukan dengan pengetahuan bahawa ianya adalah melebihi dari nilai untuk kerja-kerja pembaikan yang patut dilakukan.

[32] Having in mind the cases cited, the facts indicate that in the present case before this court for all practical purposes, the works undertaken by the plaintiff had been completed. The works even if not fully completed to specifications are matters to be arbitrated as agreed by the parties. The calling of the bank guarantees under this circumstance cannot be justified and indeed is most unfair. It also amounts to an unconscionable act by the defendant.

[33] On the defendant's reason for the demands on the bank guarantees ie, because it wants to deduct the cost of making good defects and diminution in value from the bank guarantees, this court is of the opinion that the defendant had taken the bank guarantees to its advantage unfairly simply because there are such guarantees. It acted to capitalise on the availability of these guarantees but without cogent reasons.

[34] There is no doubt the reason to provide for such guarantees in construction industry such as the one in question in the present case is to provide security to the beneficiary or owner of a particular project of construction against contractors who had failed to complete the works in time and according to specification. However that instrument in the form of the guarantees cannot been used at the whim and fancy of the beneficiary or owner. There must be concrete reason why a bank guarantee is being called.

[35] Likewise these deductions that are sought by the defendant are premature, as the plaintiffs have the right to make good defects within a reasonable time after the take over pursuant to cl. 30.5 of the contract. Towards this end, in the letter dated 8 September 2014, the plaintiffs have in fact provided a programme for making good defects and invited comments from the defendant.

[36] The deduction for diminution in value is also premature, as the tests on completion may be repeated in accordance with cl. 30.7 of the contract. In any event, the plaintiffs have never agreed to a diminution in value under appendix IV, part 1, para. 6(c) of the contract.

[37] Furthermore, these deductions, even if they were not premature, should be made on the defects liability bond, which is to be issued for the period after the take over and not on the bank guarantees that are valid before the take over, pursuant to cls. 9.1 and 10.1 of the contract.

[38] On this, there is no reason to dispute the plaintiffs have requested on 30 July 2014 that the bank guarantees be returned and offered to provide the defects liability bond.

[39] This court also is of the finding that there are genuine disputes between the plaintiffs and defendant that should be decided by arbitration on whether the defendant had in fact failed to pay the plaintiffs some certified amount. The disputes also pertain to claim for interim payment and loss and expense that the plaintiff alleges the defendant has failed, neglected and omitted to pay the plaintiffs. These disputes are not concocted by the plaintiff and ought to be heard in the arbitration. This is also another reason to find on the balance of probabilities it is unconscionable to call for the bank guarantees. After all the fact whether there is the element of 'unconscionable' depends on the facts of each particular case as decided by *Sumatec* (*supra*).

[40] Further the defendant's demands for additional sums under the bank guarantees are unconscionable, as there is the real possibility to be decided in the arbitration that there are large unpaid certified sums due by the defendant to the plaintiffs as asserted by the latter. Whether the plaintiff is able to prove this is for the arbitration to decide but it shows that it would be unconscionable for the defendant to proceed demanding the bank gurantees at this stage.

[41] In this regard the decision by the Court of Appeal in *Kejuruteraan Bintai Kindenko* (*supra*) states;

> With regards to the performance bonds in respect of the electrical work component, the final draft account prepared by the employer (GPSB) illustrates that the appellant is owed monies. As such there is no basis for the beneficiary to issue the demand in relation to the related performance bond. In fact the learned High Court Judge in his decision has made a finding that it will be unconscionable for the beneficiary to make a call on the performance bond and that the call is abusive which should warrant court intervention. In his "conclusion" at pp. 26-27 of the grounds of judgment, he said:
>
> > As regards the Performance Guarantee in relation to the electrical works component, however, the final draft account prepared by the employer (Gerbang Perdana) shows the Plaintiff is owed monies, not the reverse. It will be unconscionable to make a call on the Performance Guarantee on this. Hence on the evidence there is evident unfairness, though not dishonesty or fraud. It will however fall within the general rubric of conduct of a kind so lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party. This will be an abusive call on the relevant Performance Guarantee which should warrant court intervention without necessarily prejudicing the integrity of the security, pending the resolution of the dispute between the parties in the arbitration which has commenced.

> On the facts of the present case, this court agrees with the finding of the learned judge on this issue. Therefore, the related demand made by the beneficiary in relation to the electrical works package is clearly unconscionable and must be restrained.

[42] There is also a need by this court to express the view that it is no longer relevant to note the balance of convenience or whether damages would be adequate remedy in determining whether to allow for the demand on bank guarantees to stand. This is illustrated by the judgment of the Court of Appeal, in *Petrodar Operating Co Ltd v. Nam Fatt Corporation Bhd & Anor* [2012] 8 CLJ 311; [2012] 5 MLJ 445 where it states;

> The court said that fraud or unconscionability is the sole consideration for the court in deciding whether an interlocutory injunction should be granted to restrain a beneficiary from calling on the bond. The court need not expend energy to consider where the balance of convenience lies or whether damages will be an adequate remedy.

Conclusion

[43] This court on balance of probabilities, based on the facts of the present case, is of the view that it is unconscionable for the defendant to call on the bank guarantees. The defendant had failed to show that the demands for the same were made with justifiable reasons.

[44] The works as contracted between the parties as found by this court are completed and even if there are disputes pertaining to the same it should be decided by arbitration as agreed by both the plaintiffs and defendant.

[45] For all the reasons adumbrated, the injunction requested in the OS by the plaintiff is allowed.